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November 17, 2008

### **AGENDA ITEM 3**

#### **TO: MEMBERS OF THE INVESTMENT COMMITTEE**

- I. SUBJECT:** Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:** Ratification of Revisions to Policies relevant to the Synthetic Enhanced Equity Strategy Portfolio
  - a. Revision of Policies on Low Duration Fixed Income Program, Internally Managed Global Enhanced Equity Strategies, and Development of Derivatives Strategies

#### **IV. ANALYSIS:**

##### **Background**

The Policy Subcommittee met on October 20, 2008. The Subcommittee reviewed proposed revisions to Fixed Income, Global Equity, and Investment and Risk Management policies.

The revised Policies are attached. Unless otherwise noted, the revised Policies are presented as black-lined versions from the last adopted policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather it indicates that the term is defined in the glossary.

Each of the recommended policy revisions are explained below.

### **Synthetic Enhanced Equity Strategy**

Staff recommended changes to the following policies in consideration of the recently approved Synthetic Enhanced Equity Strategy Portfolio.

#### **Low Duration Fixed Income Program** (Attachment 1)

- Diversification limits shall be based on the assumption of a \$1 billion portfolio size for the portfolio ramp-up period (Section VII).
- The cash component of the Synthetic Enhanced Equity Strategy can be used in the High Quality LIBOR Program (Attachment A, Section I.A.1.f.).

#### **Internally Managed Global Enhanced Equity Strategies** (Attachment 2)

- Inclusion of the Domestic Synthetic Enhanced Portfolio in the Performance Objective and Benchmark Section (IV.C.).
- Inclusion of the Domestic Cash Enhancement in the Investment Approaches and Parameters Section (V.C.).

#### **Development of Derivatives Strategies** (Attachment 3)

- Change the provisions for derivative investments based on market indices to base them on mainstream indices as opposed to instruments carrying CalPERS' customization (e.g., ex tobacco, principles based investment in emerging markets, etc) (Section V).

The Subcommittee recommends ratification of the revised Low Duration Fixed Income Program policy, the revised Internally Managed Global Enhanced Equity Strategies policy, and the Development of Derivatives Strategies policy.

### **Policy Review and Consolidation Project: Adoption of Policy on Real Estate and Repeal of Related Pre-existing Policies**

Staff presented the proposed Real Estate Policy. The Subcommittee provided input and approved the first reading of the policy. The second reading of the Real Estate policy will be presented at the December Policy Subcommittee meeting.

### **Divestment Policy**

Staff recommended adoption of a divestment policy that requires CalPERS to divest or underweight an investment if CalPERS concludes that continued ownership is not prudent, or in the case of a new investment, would be imprudent. Staff also recommended that the policy include a statement that CalPERS favors constructive engagement.

The Subcommittee directed staff to return to the Policy Subcommittee in December with actual policy language based on the staff recommendations above.

### **V. STRATEGIC PLAN:**

This item supports Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

### **VI. RESULTS/COSTS:**

The results of this item will provide CalPERS with enhanced efficiencies and ability to manage the overall portfolio. The revised policies will provide a foundation for compliance, accountability, and transparency.

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Division Chief

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Interim Chief Investment Officer